

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Statutory Review of the System)	
for Regulating Rates and Classes)	Docket No. RM2017-3
for Market Dominant Products)	
Order No. 4258)	

**Comments of the
Software & Information Industry Association**

March 1, 2018

The Software & Information Industry Association (SIIA) respectfully submits these comments in response to the Notice of Proposed Rulemaking for Regulating Rates and Classes for Market Dominant Products (“NPRM” and “Proposed Rule”).

SIIA is the principal trade association for the software and digital content industry, providing global services in government relations, business development, corporate education and intellectual property protection to the leading companies that are setting the pace for the digital age.

SIIA’s Connectiv Division represents over 200 world-class business information companies who reach an audience of more than 100 million professionals. These companies drive more than \$20 billion in annual revenues, and their collective industries represent a \$400 billion global market. Together, Connectiv members represent thousands of print and online titles, with more than \$20 billion in annual revenues. Connective helps member companies of all sizes navigate the evolving content technology landscape. Connectiv members remain heavily invested in Periodicals, publishing hundreds of Periodical titles, and they mail millions of magazines, newsletters and brochures each year. These companies represent more than 10 percent of the periodicals class within the U.S. Postal Service (USPS). In addition, our members utilize first-class and standard mail extensively, and they collectively spend an estimated \$300 million in postage each year.

SIIA’s Specialized Information Publishers Division (SIPA), is the leading international organization dedicated to advancing the interests of publishers and media companies serving the needs of niche communities. SIPA represents nearly 150 members of all sizes that own and operate organizations that

produce information for various business, consumer, and educational audiences, and thousands of professionals, and that publish that publish more than 3,000 online and print publications.

I. Introduction and Summary

SIIA appreciates the oversight provided by the Postal Regulatory Commission (“PRC” and “Commission”). Although our Connectiv and SIPA members rely heavily on Periodicals mail, they are also significant customers of the Postal Service for Standard and First Class mail. Our members rely on the Commission to maintain a fair rate structure that recognizes the social and cultural value of publications we provide, and the cost that we are able to contribute to the system. We appreciate the challenges faced by the Commission by conducting the Rate System Review and proposing changes to the ratemaking system for market dominant products, as required by the Postal Accountability and Enhancement Act (PAEA). In these comments, SIIA presents the following deep concerns with the Proposed Rule:

First, the proposed rate increases presented in the NPRM are radical and unreasonable, which will result in reduced volume for all classes of mail, particularly for Periodicals mailers who are already facing a range of market challenges.

Second, the NPRM ignores the reality that a reduction in volume within the Periodicals Class will also lead to a reduction in volume of Standard and First Class mail, which are often complimentary products, creating an adverse effect on the Postal Service’s overall operating revenue.

Third, the radical increases suggested within the NPRM are in conflict with the requirements established by PAEA for just and reasonable rates, and to maximize incentives to reduce costs and increase efficiency.

Fourth, the NPRM will decrease the incentive for congressional action to make necessary structural changes to the Postal Service’s system of compensation and benefits, also known as “uncontrollable” costs.

In addition to highlighting these concerns, we also offer potential alternatives to this radical approach that would prevent the infliction of tremendous harm to postal customers and ultimately the Postal Service itself.

II. The proposed rate increases are radical and unreasonable, which will result in reduced volume for all classes of mail, particularly for Periodicals mailers who are already facing a range of market challenges.

The Proposed Rule provides for radical and unreasonable rate increases, particularly for certain classes of mail such as Periodical and others that are non-compensatory products that fail to cover their costs, where rates could rise by 30-40% (including CPI) over the next five years. The Commission notes in the NPRM that over the cost of the PAEA era, cost coverage for the Periodicals class has declined from 83% in FY 2007, to 73.7 percent in FY 2016,¹ and that this has resulted in a negative contribution of more than \$5 billion since FY 2007.² The conclusion of the recent Rate Review System is that “non-compensatory products are not reasonably or efficiently priced,” but also that these mail classes “threaten the financial integrity of the Postal Service because revenue from these products fails to cover costs.”³

This is a perplexing conclusion given that PAEA was enacted with the clear understanding that these products most likely would not be able to cover their full costs, but that the Postal Service could achieve sufficient operating revenue through other more efficient products. Congress recognized Periodicals as a loss leader, creating value for consumers from the Postal Service, while contributing significantly—if not completely—to the Postal Service overall costs. While we will address the issues surrounding cost coverage later in these comments, it is worth highlighting here that the perspective in this NPRM represents a stark departure from the historical perspective held by Congress, and the PRC, that magazines and newspapers are of intrinsic informative and cultural value and therefore worthy of subsidized delivery costs.⁴ Drawing from our regular discussions with Postal Regulatory Commissioners over the last several years, including all of the current commission, we are surprised and disappointed

¹ NPRM at 81, and FY 2016 ACD at 42.

² NPRM at 81, and FY 2016 ACD at 44.

³ NPRM at 81-82 and Order No. 4257 at 274.

⁴ USPS, Postage Rates for Periodicals: A Narrative History <https://about.usps.com/who-we-are/postal-history/periodicals-postage-history.htm>

that the Commission has completely changed its perspective in favor of achieving cost coverage. This position has not been well articulated or supported with data that indicates it is a necessity for the long-term preservation of the Postal Service, taking into considerations other opportunities outside of the rates for Market Dominant products.

Perhaps even more important than the historical treatment of Periodicals and the explicit direction from Congress in PAEA, are economic realities surrounding the Periodicals market. As we highlighted in our comments to the Commission in March 2017, data from our member companies sheds light on the significant decline in periodicals over the last decade. Companies that once relied on Periodicals for approximately 90 percent of their revenues are now likely to be deriving less than 50 percent through Periodicals, where publications have been consolidated and cost considerations are paramount. This decline is due to a range of factors, but perhaps mostly due to declining advertising revenue. The ad buying firm Magna reported that magazine ad sales fell by 13 percent in 2017 and projected a similar rate of decline in 2018.⁵ The combination of this and other factors has, in many cases, led to a significant shift to digital products and other media products and services from SIIA members.

Despite the recent declines in Periodicals titles and volume, SIIA members still report a strong commitment to certain periodicals, and they still provide a substantial contribution to the Periodicals market, particularly for specialized business customers and niche consumer markets. Discussions with member companies reveal a commitment to retain substantial focus on Periodicals, as long as they remain economically viable to produce and deliver. But from the publishers' perspective, substantial rate increases would likely precipitate further reduction in periodicals publishing, rather than allow it to stabilize around products with strong readership and revenue models, as we have seen in recent years.

While the market circumstances are somewhat different than those facing various other postal products, the decline that SIIA members are experiencing with Periodicals is not unique to our members, or even this class of mail. Rather, it is endemic of multiple factors affecting various market dominant products, albeit to varying degrees. As the Commission noted in 2017, total mail volume in 2016 dropped to levels not seen in more than 29 years, and over the last 9 years, Market Dominant products

⁵ The Not-So-Glossy Future of Magazines. NY Times; Sept. 2017.
<https://www.nytimes.com/2017/09/23/business/media/the-not-so-glossy-future-of-magazines.html>

volume declined by approximately 52 billion pieces. Approximately 42% of the volume decline occurred in FY 2009 when Market Dominant volume declined by nearly 13%.⁶ The decline in 2009 reflected greater economic challenges brought on by the Great Recession, but the continued decline across Periodicals mail indicates that the market isn't functioning effectively with current rates.

The Postal Service therefore faces a very delicate balance in its goal to recover a higher percentage of institutional costs through rate increases on Market Dominant products, particularly Periodicals, where demand is decreasing and alternative products and services are on the rise. While it is conceivable that the Periodicals class could sustain modest cost increases beyond the current annual CPI increases, the notion that cost coverage can be improved—not to mention full cost coverage achieved—and revenue can be significantly increased through substantially higher rates without further eroding mail volume is simply not credible. More likely, substantial rate increases, combined with other ongoing market challenges, will further reduce the volume and further strain the ability of the Postal Service to increase the cost coverage of Periodicals and overall operating revenue.

The Postal Service and the Commission have cited the temporary 4.3% exigent rate increase as evidence that postal rates are not elastic, and that rate increases will not lead to mail volume declines across market dominant products in general. Unfortunately, this reasoning is flawed for two reasons. First, the exigent increase was a one-time increase that was adopted as temporary, and provided for business planning for merely a limited period of time, rather than consideration of higher costs in perpetuity. Second, the rate increases proposed by the NPRM are substantially greater than the one time increase of 4.3%—the proposal would likely produce rate increases on periodicals equal to, or exceeding, the exigent increase on an annual basis for at least the next five years.

On behalf of SIIA members, we can say with a high level of confidence that the radical and unreasonable cost increases proposed in the NPRM will place too great a financial drag on their business-to-business and niche consumer periodicals, and therefore will fail to help achieve the objectives of the Commission and the Postal Service.

⁶ Testimony of Chairman Robert Taub, before the House U.S. House Oversight & Government Reform Committee, February 7, 2017 at 13.

III. The proposed rule ignores the reality that a reduction in volume within the Periodicals Class will also lead to a reduction in volume of Standard and First Class mail, creating an adverse effect on the Postal Service’s overall operating revenue.

It appears the Commission, with the proposed radical increases on Periodicals, has determined that this class of mail is simply worth eviscerating if it cannot effectively survive at much higher rates that enable cost coverage. The Proposed Rule fails to recognize that products that do not cover costs are complimentary to other products with higher cost coverage, such as Standard and First Class mail, and that these products are also likely to see a significant decline in volume and overall USPS revenue contribution due to the drastic rate increases on Periodicals. Therefore, in addition to the challenges stated above with respect to significantly decreasing Periodicals revenue, the Postal Service is likely to suffer further decreases in revenue resulting from a reduction in volume among First Class and Standard Mail, both of which have higher cost coverage ratios. That is, our members periodicals (as well as the Periodicals Mail class overall), generate a substantial amount of complementary mail products, such as renewal notices, invoices and other associated mail products that would not be in the mail stream if not for the role of the Periodicals.

Feedback from SIIA members provides additional insight into the relationship between these related products. While it is difficult to produce a precise average correlation of complimentary mail products for Periodicals, feedback from SIIA members enables us to estimate that for many periodicals, the amount spent on postage for each periodical to a unique customer, also presents nearly one-third of additional revenue for the Postal Service in Standard and First Class mail. While we have not had the opportunity to collect detailed data from each of our members in the Periodicals Mail business, we estimate that for every dollar spent mailing periodicals, these companies spend in the range of \$.20-\$.35 on complimentary mail products. Below is a rounded example of SIIA member spending on one of its flagship publications, and the spending on complimentary mail associated with that periodical.

\$2,000,000	Approx. 7 Million pieces of Periodical Mail (sent through printer achieving the lowest possible rate through co-mail service)
\$40,000	Mailed Invoices – First Class Mail
\$315,000	Renewal notices – Standard Mail
\$300,000	Promotional direct mail (approx. 1.2 million pieces) – Standard Mail

Our findings are consistent with the research of other industry groups, where assessments about USPS profitability indicates that some titles/publishers are profitable due to mailing large amounts of Standard Mail, and that other non-Periodical postal products offset about 62% of the contribution losses from Periodicals. The Commission should take this into consideration when assessing the contribution of Periodicals, and be mindful that significant rate increases for Periodicals will lead not only to a decline both overall number of Periodicals and volume, but also a significant decline in First Class and Standard mail volume and revenue.

Another possible outcome that we heard from members is that an increase in the rates for Periodicals could require a cost shift whereby they seek to reduce costs spent on these complimentary products—either by reducing them entirely or seeking to increase digital products in place of mail products—in order to maintain the viability of their periodicals. Obviously, this would be the worst possible outcome for the Postal Service. Either way, it is likely that the revenue sought by the proposed rate increase for periodicals will not come close to the revenue desired by the Postal Service.

IV. The proposed radical increases are in conflict with the requirements established by PAEA for just and reasonable rates, and to maximize incentives to reduce costs and increase efficiency.

PAEA established a modern system of regulating rates and classes for Market Dominant products, based on a set of key objectives and requirements, and it mandated that the Commission review this system after 10 years to assess whether the system is meeting the stated objectives. As part of this review process, PAEA also provided the PRC with the authority to “make modifications or adopt an alternative system as necessary to achieve the objectives.” Importantly, PAEA did *not* provide the Commission with the authority to establish new objectives, or to ignore certain objectives or requirements to the benefit of other objectives, or to establish new requirements, but to achieve the existing statutory objectives.

Among the objectives established by PAEA are to maintain a system of rates for Market Dominant products to be “just and reasonable,” and it also specifically sought to maximize “incentives to reduce costs and increase efficiency.”⁷ These are core statutory objectives that Congress clearly did not

⁷ 39 U.S.C. 404(b), 3622(b)(8) and 39 U.S.C. 3622(b)(1)

intend for the Commission to ignore, despite the Commission's authority to make modifications or create a new rate system. Quite clearly, the drastic rate increases presented by the Proposed Rule would fail to conform with these explicit objectives established by PAEA.

First, with respect to the requirement for just and reasonable rate increases, the size of the proposed annual rate increase for Periodicals—especially combined with the challenges facing the periodicals market—are not just and reasonable. As discussed above, they are a departure from historical treatment of Periodicals, and an opportunity for the Postal Service to raise rates practically at will, as long as new increases are aimed at full cost coverage.

Over the span of the 10-year rate cap, our members have reported an average increase of approximately 10-15%, despite leveraging co-mail and other cost-cutting measures that have led to substantial costs savings for both mailers and the Postal Service. Regardless, the Postal Service has been allowed to raise rates continually, with an average increase of more than 1% per year. While the Postal Service has found these increases to be insufficient to keep up with costs, this cost challenge contrasts with the market for production of our members periodicals over the same period. That is, on average, printing and other production costs have *declined* slightly over this period as a result of productivity and economies of scale—this is a practical result of technological advancement and increased productivity in a competitive market. From this perspective, it is hard to see how the proposed rate increases for Periodicals in the range of 30-40% over the next five years could stand up to challenges as “just and reasonable.”

Second, the proposed rate increases would fail to incentivize cost savings and efficiencies within the Postal Service. To the contrary, the Proposed Rule would create a system where the Postal Service can increase rates to enable cost coverage, including long-term capital expenditures, regardless of what these costs are. As Commissioner Hammond highlighted, “if the Postal Service's costs (particularly its structural costs) increase unexpectedly, the logic of this Order would require ever-increasing prices, even if that would drive away mail volume at a rate that could put the Postal Service out of business.”⁸ This is exactly the scenario that we expect if the proposed rate increases go into effect, whereby

⁸ Commissioner Tony Hammond dissenting opinion at 140

inefficient practices will be less of a critical focus on the part of the Postal Service, to the peril of mail volume, postal customers and ultimately the financial stability of the Postal Service.

This is a very likely, but impractical, scenario for the future. As noted in the Postal Service's FY 2016 Form 10-K statement "...our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high-quality service and meet the needs of the American public.... An aging or potentially obsolete infrastructure could result in loss of business and increased costs."⁹ Therefore, the inability of periodicals—and various other classes of mail—to cover their attributable costs does not reflect a price that is too low, but rather the excessive costs of an inefficient system that the Postal Service has stuck with for too many years.

The failure to achieve greater cost coverage over the last decade is a function of excessive costs, not constrained ratemaking authority. Despite significant investment by the Postal Service to improve automation of flats and promote growth in mailer work-sharing, these goals simply have not been achieved. The inflation adjusted unit costs reported by the Postal Service for Periodicals Mail increased by 69 percent from FY 1985-FY 2014. During this period, automation of the flats mail stream and the amount of work-sharing increased. At the same time, there has not been documentation of any trends that can be attributed to offsetting this progress and leading to increased costs. Indeed, this is a mysterious *increase* in costs for processing magazines and catalogues, rather than the planned reduction.

One of the key contributors to this unexpected cost increase is the performance of the Flats Sequencing System (FSS) machines, which the Postal Service invested heavily in and began rolling out more than eight years ago to improve the handling of flat mail, including publications. The challenges have only been increasing. According to the FY 2016 Annual Compliance Report (ACR), FSS throughputs declined 6 percent the previous year, and the proportion of FSS mail that was sorted on older equipment or manually rose from 40 to 43 percent. "Mail Pieces At-Risk" also rose 6 percent, affecting 1 of every 18 magazines, catalogs, and retail flyers.

⁹ Postal Service's FY 2016 Form 10-K statement.

We have maintained a long-standing commitment to improve operational issues to improve the cost coverage of periodicals. To that end, we have worked diligently with the USPS since 2010 to identify and implement efficiencies which can improve both periodical cost coverage and service performance. Specifically, we have been active participants in the Mailers Technical Advisory Committee (MTAC), attending quarterly meetings and participating in additional efforts, such as the USPS and Industry Flats Strategy Group, and engaging our member companies to improve processing efficiencies.

In 2011, periodical mailers worked with the Postal Service and agreed to more relaxed critical entry times applying to service standards. These changes were expected to result in more efficient use of postal flats processing equipment and personnel. In 2015, those critical entry times were relaxed even more. Unfortunately, the result was a decline in Periodicals service performance. From fiscal year 2014 through the second quarter of 2016, overall performance declined from about 81 percent to 76.5 percent and end to end performance from 66 percent to 59 percent. Destination Entry service declined from about 86 to 82 percent. These results are not close to the established Postal Service goal for Periodicals of 92 percent.

The Network Rationalization Initiative, a reduction in the number of processing facilities, was supported by a large majority of the mailing industry, and it was implemented to take cost out of the system while maintaining service levels. The mailing industry has also worked with the Postal Service on other specific areas of concern including bundle breakage and more efficient mail makeup rules, including mail make-up rules for the FSS equipment. Results of these efforts has unfortunately been substantially below expectations. These are all examples that the Commission has already closely examined, and we are therefore particularly disappointed that the Commission would propose radical rate increases towards greater cost coverage, rather than seeking to modify the system to enable the Postal Service to better take advantage of modernization and efficiencies to achieve greater cost coverage for periodicals.

The Commission's objective, given the declining-volume reality of Market Dominant products, therefore must achieve increases in efficiency and cost controls, rather than merely seeking to cover inefficiencies and runaway costs with exorbitant rate increases. SIIA urges the Commission to reconsider the Proposed Rule, as it falls short of achieving the core statutory requirements of PAEA and

is not likely to stand up to a legal challenge that could take years to litigate and further waste scarce federal resources to defend.

V. The Proposed Rule will decrease the incentive for congressional action to make necessary structural changes to the Postal Service’s system of compensation and benefits, also known as “uncontrollable” costs.

The Commission is currently tasked with an overly-narrow endeavor, merely to propose and implement regulations to address flaws in the market dominant ratemaking system. The Commission’s task is to assess whether PAEA’s range of objectives are being met, and in the event that they are not, to attempt improvements via the use of one tool alone—reform to the system for regulating rates and classes for market dominant products. As the Commission itself has noted, this singular device—the ratemaking system—is all that may be wielded by the regulator in an effort to achieve these objectives.

However, it is widely recognized that modifications to the rate system could not be expected to substantially improve the financial position of the Postal Service. That is, the statutorily-imposed uncontrollable costs, such as the requirement to pre-fund retirees’ health benefits and other benefits, such as workers’ compensation, has created payment obligations that cannot reasonably be met through postal rate increases alone, as the Commission itself has recognized publicly.¹⁰

The need for Congress to rectify the situation has been noted by the Commission on many occasions. As highlighted by Chairman Taub in 2017, “the accruing nonpayment into the statutory retiree health benefit fund and the long-term workers’ compensation obligations have artificially skewed the Postal Service’s current liabilities in relation to its assets. To reduce its debt ratio to historic averages, the Postal Service would have to significantly increase its current cash position or investments in capital assets and reduce its obligations to the PSRHBf.”¹¹ This sentiment was affirmed recently by Commissioner Acton, who highlighted that, “[m]any of the Postal Service’s greatest challenges are not a primary result of the rates that it charges its customers and partners. Comprehensive legislative reform

¹⁰ Testimony of Chairman Robert Taub, before the U.S. House Oversight & Government Reform Committee, February 7, 2017.

¹¹ Ibid at 13.

is best suited for brokering compromise and tailoring outcomes in this landscape where such divergent interests must coexist.”¹²

Despite the Commission’s clear recognition that congressional action is needed to resolve the fiscal state of the Postal Service, this NPRM would undermine the opportunities for critical legislative action. That is, the signal that will be sent by the Proposed Rule is that significant new rate authority for the Postal Service will substantially, if not fully, improve the financial standing of the Postal Service. By providing dramatic rate increases, the NPRM will also greatly remove the incentive for the Postal Service to support legislation that achieves much needed 21st Century reform of the Postal Service, including but not limited to its uncontrollable costs. Given the difficulties for Congress to reach bipartisan, bicameral agreement on major reform legislation, this Proposed Rule will all but eliminate hope for the legislative reforms that the Postal Service, postal customers, and the Commission have long sought.

VI. Conclusion and possible Alternatives for the Commission.

As discussed above, the Proposed Rule represents a very flawed approach. The Commission should first seek to “do no harm” with respect to changes to the system of rates for market dominant products. The Commission should continue to urge Congressional action, and not take steps that indicate the USPS fiscal problems can be significantly addressed by higher rates—this is simply untrue, but it is the message provided by the NPRM. Because the situation is already tenable and fluid, radical rate increases should be avoided at all cost.

If the Commission determines it absolutely necessary to provide for a rate increase at this time to ensure near-term stability of the Postal Service, there are more practical approaches the Commission could take: First, utilizing the exigent surcharge capability, could provide substantial additional revenue without completely departing from the rate cap and abandoning the structure established by PAEA. Through this process, the Commission could make changes to this process to make it more flexible, and to ensure that it is tied more closely to incentives to reduce costs and increase efficiency, keeping with the core objective of PAEA.

¹² Supplemental Statement of Commissioner Mark Acton at 136

Second, whatever conclusion the Commission reaches for instituting changes to the ratemaking system for market dominant products, and particularly if the Commission retains the drastic rate increases, the Commission should provide for a delayed implementation of these changes and a clear recommendation to Congress and the Office of Management and Budget (OMB) that the changes will go into effect only after a period during which Congress chooses not to, or fails to reach consensus, on broader legislative reforms to address the systemic, uncontrollable costs of the USPS. A reasonable time period for Congressional review and action would be at least 18 months.

Outside of this process, looking more broadly at the revenue capability of the Postal Service, SIIA is pleased that the Commission has issued a Notice of Proposed Rulemaking on Minimum Contribution of Competitive Products to Institutional Cost. Annual modifications to reflect changes in market conditions are long overdue. The postal market is experiencing fundamental changes, as it has been over much of the last decade. We have seen a pattern where First Class, Periodicals, and other Market Dominant products are in decline, while parcel volumes are increasing steadily. These trends have been ongoing for several years, ironically both greatly affected by the rise of the internet. While the internet has given rise to automated—paperless—business processes and new digital information products that sometimes replace or reduce demand for Periodicals, they have had the opposite effect on parcels. The rise in online shopping has, at the same time, created a boom for Parcel service. This new growth has demonstrated the opportunity for significant revenue increases for the Postal Service, even while the volume of Market Dominant products has decreased.

Competitive Products collectively are the fastest growing segment of the Postal Service's market, and they comprise an increasing share of Postal Service revenue and volume. Therefore, these products should be expected to bear a much greater share of the Postal Service's institutional costs going forward. Towards the goal of maximizing the Postal Service's Profits from Competitive Products, we concur with the recommendation for the PRC to gradually increase the share of institutional costs that it requires the Postal Service's competitive product revenues to cover. In doing this, the Commission would be able to identify the share that maximizes the Postal Service's profits based on readily observable data.¹³

¹³ Sidak, J. Gregory. [Maximizing the U.S. Postal Service's Profits from Competitive Products](#); *Journal of Competition Law & Economics*. September 9, 2015.

While the outlook for either of these markets is not entirely clear over the next decade—and farther into the future—it is reasonable to expect based on changes in the markets that Parcels volume will continue to increase and Market Dominant volume either remains relatively flat or further declines. Therefore, increasing the minimum contribution of competitive products to the institutional cost of the Postal Service is yet another opportunity that the Commission can utilize outside of this narrow process that presents more peril than opportunity for the Postal Service.

Thank you for the opportunity to provide comments on this important process. Respectfully submitted, Software & Information Industry Association.

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